United States Court of Appeals

for the Second Circuit

PETITION FOR REHEARING

75-4162

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In The

UNITED STATES COURT OF APPEALS
For The Second Circuit

Docket No. 75-4162

SEYMOUR SILVERMAN, Et Al.,
Petitioners-Appellants,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

PETITION FOR REHEARING

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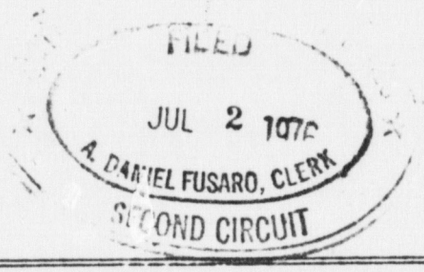

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PETITION FOR REHEARING

The appellants above named respectfully petition the Honorable Court for a rehearing of the appeal in the above-entitled cause, and in support of this petition represent to the Court:

We reserve our argued position as to each of the points of appeal, but in this petition address ourselves solely to those features of the decision wherein we believe the Court may be convinced its result is based upon the application of incorrect legal principles.

Taxpayer's appeal from the decision below was not predicated on the Commissioner of Internal Revenue having initially the burden of proof, or on a challenge to the Tax Court Rule 142(a). The thrust of taxpayer's argument is that the Commissioner's presumption of correctness only applies to the allegation in the statutory notice of deficiency and once that notice is determined to be erroneous, the presumption falls.

Once the presumption of correctness falls and petitioners submit credible proof, the burden then shifts to the respondent. His only proof, the testimony of Hugh MacMullen, III, as detailed analysis has shown, is completely unreliable and was rejected by the Court below.

The determination of error may be by a court[1/] or may be by the Commissioner's own admission of gross error. Rule 142(a) is not new with the Tax Court; its predecessor Rule 32 was in effect when the various cases cited by the petitioners-taxpayers were decided.

1/ Helvering v. Taylor, 70 F. 2d 619 (2nd Cir. 1934) affd. 293 U.S. 507 (1935)
Kaufman v. Commissioner, 372 F. 2d 289 (4th Cir. 1966)
Cohen v. Commissioner, 266 F. 2d 5, 12 (9th Cir. 1959)
MacCrowe's Estate v. Commissioner, 252 F. 2d 293 (4th Cir. 1958)
Federal National Bank of Shawnee, Oklahoma v. Commissioner, 180 F. 2d 494 (10th Cir. 1950)

The opinion of the Second Circuit in this case cites McMurty v. CIR, 203 F. 2d 659 (1st Cir. 1953) and Marx v. CIR, 179 F. 2d 938 (1st Cir.)

Petitioners respectfully contend that those cases are distinguishable on the facts and not applicable to the Silverman case.

In Marx v. CIR, supra, relied on by the Court in McMurty, the deficiency resulted from disallowed deductions with respect to which the taxpayer had the burden of proof as to each item and each amount. The fact that after the statutory notice of deficiency is issued, the Commissioner or the Court is satisfied that some items are allowable, does not remove the petitioner's burden of proof with respect to the other items.

In McMurty v. CIR, supra, the change in Commissioner's position was not in the value of the asset itself, but in the percentage of the asset to be subject to gift tax.

Initially, the Commissioner had issued the statutory notice of deficiency valuing a trust set up to provide a life interest for a wife in connection with a divorce with remainder to their daughter at the full value of the corpus. This was a reversal of a prior position given in a letter ruling in connection with an earlier divorce.

Prior to trial, the Commissioner issued E.T. 19, 1946-2 C.B.166, wherein he recognized that "transfers made pursuant to legal separation agreements or divorce decrees" may constitute consideration in money or money's worth. In conformity with such ruling, the Commissioner reduced the amount subject to gift tax. This is totally different from recognizing that the value ascribed to a gift was so arbitrary and capricious that it is reduced by the Commissioner himself by about 50% at time of trial. Other cases wherein the Commissioner's reduction in deficiency did not cause the presumption of correctness to fall were unexplained bank deposit cases[2/] wherein the Commissioner's determination is presumptively correct with respect to each deposit (a separate item of income). The fact that some items are satisfactorily explained and eliminated from income before trial does not negate the presumption of correctness with respect to the other items.

2/ Farber, 43 T.C. 407 (1966)
Fada Gobins, 18 T.C. 1159 (1952)

If the clearly expressed statements of the Second,[3] Fourth,[4] Ninth,[5] and Tenth Circuits[6] have any meaning, it is that the presumption of correctness applies only to the determination in the statutory notice of deficiency and if such determination is arbitrary and capricious, the petitioner need show it is only invalid, and not establish the correct amount of tax due.

Up to and even during the trial, the Commissioner had not amended the statutory notice of deficiency to a reduced amount. It was only during a chamber conference just prior to presentation of his case that the Commissioner stated he was limiting his deficiency to an amount based on $25 a share for Class B stock of Modern Maid Food Products Inc.

Does a taxpayer have to show or a Court find the invalidity if the Commissioner himself admits it? By the simple expediency of reducing his claim with respect to a single item at trial may the Commissioner suddenly defeat decisions of the Circuit Courts?

3/ Helvering v. Taylor, 70 F. 2d 619 (1934)
4/ Kaufman v. CIR, 325 F. 2d 934 (1963); MacCrowe's Estate v. CIR, 252 F. 2d 293 (1958)
5/ Cohen v. CIR, 266 F. 2d 5 (1959)
6/ A & A Tool & Supply Co., et al. v. Commissioner, 182 F. 2d 300 (10th Cir. 1950); Federal National Bank of Shawnee, Okla. v. CIR, 180 F. 2d 494 (1950).

With respect to the discount of approximately 7% given the non-voting stock in 1969, petitioners submit that the exchange was voted at the same time the agreement with Ladenburg, Thalmann Co. was approved by the shareholders. Such a discount is the maximum discount in accord with financial history for publicly traded securities. However, in a closely held company, the Tax Court itself recognized a discount of almost 40% attributable solely to non-voting restrictions. Estate of Greg Maxcy, TCM 1969-158. In that case the non-voting stock representing 99% of the capitalization was given a value of 60% of the capitalization.

Petitioners are well aware that the Tax Court may use evidence before it to determine its own value, but said value must be a reasonable one. The Tax Court applied a multiple of 10 to Modern Maid Food Products earnings to arrive at a figure of $40 a share for the Class A stock and then $37 a share for the non-voting Class B stock.

Frankly, it boggles the mind to conceive anyone would pay almost $3,000,000 (79,360 shares x $37) for stock in a closely held corporation, paying no dividends, with no plans to go public and when the controlling shareholder intended his sons to have his voting stock some time in the future. Such

purchaser would be without a voice in the company, with regard to employment, dividends, "going public", merger or liquidation. By the very terms of the charter, this condition would prevail through the buyer's lifetime and beyond.

What the Court below did, that this Appeals Court is sustaining, is to determine a valuation for Class A stock as if it were already a public company.

To gather some idea of the magnitude of the error of the Court below, reference is made to the appraisal report of respondent's own expert witness. MacMullen used an earnings multiple of 14.2 in one method and 13.47 in another method and arrived at a value of $25 a share; the Tax Court using a multiple of 10 arrived at a value of $37 a share. Said multiple of 10 applied to MacMullen's own method would give a value of approximately $14 a share for the Class B stock.

Certainly valuations involving substantial tax should not be a matter of which Judge hears the case. In Kirkpatrick v. CIR, TCM 1975-344, the Tax Court determined a discount of 50% from actual value of the assets for stock in a closely held corporation due to lack of marketability. Even MacMullen acknowledged that discounts for minority interests in a closely held corporation run as high as 50% for voting stock. The

Court below made no allowance for such factors in this case. The determination was clearly erroneous.

For the foregoing reasons, the petition for rehearing should be granted.

Respectfully submitted,

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Attorneys for Petitioners-Appellants

June 30, 1976

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753-2900

July 1, 1976

The Clerk
United States Court of Appeals
Second Circuit
Foley Square
New York, N. Y. 10007

Re: Seymour Silverman, Et Al.,
v. Commissioner of Internal Revenue
Docket No. 75-4162

Dear Sir:

Enclosed are ten copies of Petitioners' Petition For Rehearing to be filed in the subject case. Also enclosed is an affidavit of service.

Very truly yours,

WAGMAN, CANNON & MUSOFF, P.C.

By: Barry D. Gordon
Barry D. Gordon

BDG:db
Enclosures
Certified Mail

cc: w/Enclosures (2)
Scott P. Crampton, Esq.
Assistant Attorney General
Tax Division
Department of Justice
Washington, D.C. 20530
Att: Elmer J. Kelsey, Esq.

AFFIDAVIT OF SERVICE

STATE OF NEW YORK)
: ss.:
COUNTY OF NEW YORK)

DOROTHY BREEN, being duly sworn, deposes and says: That deponent is not a party to the action, is over 18 years of age and resides at 136 East 57th Street, New York, N. Y. That on the 1st day of July, 1976, deponent served the within PETITION FOR REHEARING upon SCOTT P. CRAMPTON, Assistant Attorney General, Tax Division, Department of Justice, Washington, D.C. 20530, Atttention: ELMER J. KELSEY, ESQ., Attorneys for COMMISSIONER OF INTERNAL REVENUE, at the address above designated, by depositing two (2) true copies of same enclosed in a postpaid properly addressed wrapper in a post office - official depository under the exclusive care and custody of the United States Post Office Department within the State of New York.

Dorothy Breen
Dorothy Breen

Sworn to before me, this
1st day of July, 1976.

Notary Public

BARRY DEAN GORDON
Notary Public, State of New York
No. 41[illegible]13
Qualified in Westchester County
Commission Expires March 30, 1977